Agenda Date: 11/08/01
Agenda Item: 2C

STATE OF NEW JERSEY

Board of Public Utilities

Two Gateway Center
Newark, NJ 07102

IN THE MATTER OF THE APPLICATION OF EAGLE POINT COGENERATION PARTNERSHIP ("EAGLE POINT") AND PUBLIC SERVICE ELECTRIC AND GAS COMPANY ("PSE&G") FOR THE APPROVAL OF AN AMENDMENT AND RESTATEMENT OF THE POWER PURCHASE AND INTERCONNECTION AGREEMENT AND GAS SERVICE AGREEMENT CURRENTLY EXISTING BETWEEN EAGLE POINT AND PSE&G	)	ENERGY DECISION AND ORDER DOCKET NO. EM01080489

(SERVICE LIST ATTACHED)

BY THE BOARD:

By letter dated August 14, 2001, Public Service Electric and Gas Company ("PSE&G" or "Company") and Eagle Point Cogeneration Partnership ("Eagle Point") (collectively, "Co-Petitioners") filed a petition with the Board of Public Utilities ("Board") to approve an Amended and Restated Power Purchase Agreement ("Amended PPA"), an Interconnection Agreement, an Amended and Restated Gas Service Agreement ("Amended Gas Service Agreement") and a Gas Call Agreement (the last two agreements collectively, "Gas Agreements") between PSE&G and Eagle Point. Co-Petitioners have also requested expedited treatment of this matter and confidential treatment of certain portions of the petition. A copy of the petition was served upon the Division of the Ratepayer Advocate ("Advocate").

Background

El Paso Corporation controls the entities owning the Eagle Point facility ("Facility")[1]. An affiliate of El Paso Corporation, El Paso Merchant Energy, L.P. ("El Paso") is an energy trading company with expertise and experience in running merchant power plants throughout the country. Merchant power plants are independent generation facilities that are able to sell their capacity and energy in the open electricity market. The petition refers to Eagle Point as "Seller" and obligor under all the agreements, even when the actual obligor is one of Eagle Point's affiliates. One affiliate of Eagle Point, Cedar Brakes III, L.L.C., is the signatory to the executed Amended PPA provided with the petition. Upon the effective date of the Amended PPA, Eagle Point will transfer and/or assign its rights and obligations under the Existing PPA to Cedar Brakes III, L.L.C. and, accordingly, Cedar Brakes III, L.L.C. will be the Seller under the Amended PPA. Eagle Point will be the signatory to the Interconnection Agreement and the Amended Gas Service Agreement. Eagle Point asserts that, because of restrictions in its lender

[1] At its inception, the Facility was owned by an affiliate of PSE&G, Community Energy Alternatives, Inc. (50%) and ANR Venture Eagle Point Company (50%). The entities that currently own the Facility are: ANR Venture Eagle Point Company (0.17%); ANRV Eagle Point, L.P. (83.49%); and Mesquite Investors, L.L.C. (16.34%).

agreements, it could not execute those agreements under which it will be the signatory without first receiving lender approvals. Accordingly, in lieu of executing the Interconnection Agreement and the Amended Gas Service Agreement, Eagle Point has supplied letter agreements that require Eagle Point to sign the agreements when lender approvals are obtained. The petition indicates that the executed signature pages for Seller will be provided to the Board as soon as they become available. Another affiliate of Eagle Point, El Paso, is the signatory to the Gas Call Agreement.

Eagle Point

Eagle Point owns and operates a gas-fired, combined-cycle, cogeneration facility rated at approximately 195 megawatts ("MW") summer capacity and 220 MW winter capacity. On February 5, 1988, Eagle Point and PSE&G entered into a Power Purchase and Interconnection Agreement ("Original PPA"), pursuant to which Eagle Point agreed to sell to PSE&G, and PSE&G agreed to purchase from Eagle Point, at pre-established prices, 100% of electrical power output produced by the Facility, net of the energy and capacity consumed by the Facility's in-plant load and the on-site electrical requirements of its thermal host, the Coastal Eagle Point Oil Company's ("Coastal") refinery. The Original PPA was entered into in recognition of PSE&G's obligations under the Public Utility Regulatory Policies Act of 1978 ("PURPA"), as implemented by the Federal Energy Regulatory Commission ("FERC") and the Board. The Board approved the Original PPA by Order of Approval dated December 23, 1988 and Order of Clarification dated April 14, 1989, in Docket No. EM88020331. The Original PPA was subsequently amended by a First Amendment dated April 25, 1991 ("Existing PPA"). The Board approved the First Amendment by Order dated August 9, 1991, in Docket No. EM88020331.

In order to provide fuel for the Facility, Eagle Point entered into a Gas Service Agreement ("Existing Gas Service Agreement") with PSE&G on July 5, 1990, pursuant to which PSE&G agreed to provide interruptible natural gas service to the Facility over a 20-year term. The Board approved the Existing Gas Service Agreement by Order dated December 17, 1990, in Docket No. GR89120978.

Under the Existing PPA, the energy charge is based on an Adjusted Base Rate composed of three components: (1) a fixed component of two cents per kilowatt-hour ("kWh"); (2) a fuel component that fluctuates with the price of natural gas and changes monthly; and (3) a GNP deflator component that changes annually. The Existing PPA provides for a Monthly Energy Charge, calculated by multiplying the number of kWh delivered by Eagle Point during the month by the Adjusted Base Rate. For capacity charges, the Existing PPA provides for capacity payments based on on-peak energy deliveries. The Monthly Capacity Charge is the number of kWh delivered by the Facility during the on-peak hours, divided by the number of on-peak hours and multiplied by a capacity rate of $9.04 per kW-month in 2001. The capacity rate escalates at a rate of 4.9% annually. The Existing PPA has a term of twenty-five (25) years from the date of first commercial operation, which was May 1, 1991, and ends on April 30, 2016.

Amended PPA

The Amended PPA amends the obligations of the Existing PPA. Under the Amended PPA, Seller will provide to PSE&G the same total amount and approximate profile of energy and capacity that the Facility was forecasted to provide under the Existing PPA.[2] Co-Petitioners assert that, over the term of the Amended PPA, which will terminate April 30, 2016, Seller will supply energy and capacity to PSE&G from a portfolio of resources, which may include the Facility, at fixed rates that are the same as the current and estimated future rates in the Existing PPA.[3] As discussed above, the Existing PPA contains three pricing components: (1) a fixed cost component; (2) a fluctuating monthly fuel component; and (3) an annual GNP deflator component. Together, these components comprise the variable monthly price of energy. The Amended PPA eliminates these individual components and, instead, establishes fixed energy prices for the duration of the term of the Existing PPA, based upon a projection of energy costs for the duration of the agreement. Co-Petitioners assert that the fixed energy prices were established utilizing a natural gas forecast dated June 28, 2001.

The terms of the Amended PPA provide that, in return for providing this flexibility to Seller, and rather than reducing the Existing PPA's prices and having the benefits of such a price reduction inuring to PSE&G and its customers on a monthly basis over the remaining terms of the Existing PPA, PSE&G will receive a payment ("Restructuring Credit"), in the amount of $100 million, payable at the closing of this transaction. Co-Petitioners assert that, all other things being equal, the Restructuring Credit, on a net present value basis, is equivalent to a 7.6% reduction from current and estimated future rates in the Existing PPA. Co-Petitioners state that PSE&G will credit this full amount to its non-utility generation transition charge ("NTC") deferred balance, thereby allowing customers to receive the full and timely benefit of the Amended PPA. Co-Petitioners assert that applying the $100 million payment as an up-front credit to the NTC will directly benefit PSE&G's NTC deferred balance, estimated by PSE&G to be over-recovered by $5 million on January 1, 2002, thus creating an estimated deferred balance surplus of $105 million as of that date. The deferred balance surplus will accrue interest pursuant to the Board's directive in its Final Order ("PSE&G Final Order") dated August 24, 1999, in Docket Nos. EO97070461, EO97070462 and EO97070463. Moreover, Co-Petitioners assert that the Amended PPA will provide the additional benefit of removing the uncertainty inherent in the Existing PPA' s energy pricing structure, which is currently approximately 46% fuel-related

In order to improve the reliability of energy deliveries, and to maintain delivery schedules consistent with the Existing PPA structure under which Seller has incentives to schedule power deliveries during peak hours and peak periods, the Amended PPA includes peak period minimum energy delivery obligations. This obligation includes a guaranteed minimum delivery of 200 MWh per on-peak hour during the summer months (June through September). Co-Petitioners assert that the energy and capacity delivered under the Amended PPA is firm and is no longer subject to the operational risks inherent in the Facility. Co-Petitioners assert that any failure by Seller to deliver energy and/or capacity under the Amended PPA is addressed through liquidated damages provisions that will fully compensate PSE&G if the Seller fails to meet its contractual delivery guarantees.

Even though power will no longer be required to be supplied from the Facility, and the Facility will be operating in a merchant mode, the Amended PPA provides that Seller will arrange for 195 MW of capacity credits to be made available to PSE&G from a PJM Capacity Resource(s), as defined in the PJM Reliability Assurance Agreement. Co-Petitioners assert that this

[2] A schedule showing the annual energy deliveries is attached to the petition as Exhibit F. Co-Petitioners have requested that Exhibit F and the information contained therein be kept confidential.

[3] A schedule showing the contract rates is attached to the petition as Exhibit E. Co-Petitioners have requested that Exhibit E and the information contained therein be kept confidential.

provision will ensure that capacity from the Facility, or an equivalent amount of capacity from other sources meeting PJM eligibility requirements, will continue to be made available to assure reliable service for PSE&G's customers in the PJM region, and as needed for PJM system emergencies.

The Amended PPA provides that the energy will be delivered to PSE&G at the existing point of interconnection between PSE&G and the Facility. The Amended PPA also allows for Seller to deliver at any other delivery point in the PJM system; however, any locational marginal pricing differences for such other delivery point(s) will be trued up hourly so that deliveries are priced as if they were delivered at Eagle Point. Seller is responsible for all transmission charges and congestion costs to any and all of these alternate delivery points. Additionally, the Amended PPA provides that, in the event that the Facility prospectively engages in any energy sales that constitute "on-site generation" within the meaning of N.J.S.A. 48:3-77, Seller will reimburse PSE&G for any societal benefits charges, market transition charges and transition bond charges that PSE&G would otherwise have collected in connection with such sales. Accordingly, Co-Petitioners assert that the Amended PPA mitigates potential revenue losses that PSE&G and its ratepayers might otherwise suffer.

PSE&G and Seller recognize that the Restructuring Credit under the Amended PPA does not reduce the Existing PPA's rates to anticipated market clearing levels. The Amended PPA specifies that its implementation will not increase the breakage costs[4] that would be associated with a future buydown or buyout of the Amended PPA by PSE&G.

The Amended PPA modifies the Existing PPA in three major respects that constitute the consideration for the up-front Restructuring Credit of $100 million. The Amended PPA: (1) eliminates the requirement that Seller maintain its status as a "qualifying facility" under PURPA; (2) gives Seller the right to meet its supply obligations from any available source rather than being required, as it is currently obligated under the Existing PPA, to supply PSE&G solely from the Facility; and (3) provides Seller with make-up rights[5] in the event deliveries are curtailed due to force majeure occurrences. Co-Petitioners assert that the above modifications will enable Seller to meet the delivery obligations under the Amended PPA more efficiently than is currently the case, and that these changes will permit Seller to operate the Facility as a competitive merchant power plant in the PJM region in an economically rational manner.

Currently, the Coastal refinery obtains electric energy and capacity from the Facility to meet the power requirements of the refinery. Co-Petitioners assert that, as a result of the Amended PPA and conversion of the Facility to merchant mode operation, the Coastal refinery will no longer receive electric supply from Eagle Point, and will instead return to PSE&G as a tariff distribution customer under the Company's Rate Schedule HTS – High Tension Service. Co-Petitioners assert that the return of the Coastal refinery as a full requirements distribution customer will result in an estimated additional contribution to PSE&G's wires charge accounts of approximately $2.3 million annually at current rates. Because these accounts are subject to full cost recovery with deferred accounting, these new contributions from the Coastal refinery will provide a direct additional benefit to PSE&G's customers above and beyond the benefits derived from the payment to PSE&G of the up-front $100 million Restructuring Credit.

[4] The term "breakage costs" is referenced in Article XIII of the Amended PPA. As used therein, breakage costs are costs associated with the negotiation of any future buydown or buyout of the Amended PPA by PSE&G.

[5] The term "make-up rights" as used herein, and as described in detail in Article V, Section D of the Amended PPA, refers generally to the ability of Seller, subject to certain constraints, to reschedule deliveries of energy that Seller originally scheduled, but that PSE&G is unable to accept for various reasons.

Interconnection Agreement

PSE&G and Seller have separated the interconnection provisions of the Existing PPA and have entered into a separate new Interconnection Agreement. The Interconnection Agreement allows for the Facility's continued interconnection with PSE&G. Co-Petitioners assert that the Interconnection Agreement allows the Facility continued safe and adequate access to the transmission grid. Co-Petitioners assert that the Board's approval of the Interconnection Agreement is a necessary condition precedent to the effectiveness of the Amended PPA.

Gas Agreements

As noted above, by Order dated December 17, 1990, in Docket No. GR89120978, the Board approved the Existing Gas Service Agreement between Eagle Point and PSE&G. Under the Existing Gas Service Agreement, PSE&G provides natural gas transportation service from the point of connection with the interstate pipeline to the Facility. Currently, all revenues associated with the Existing Gas Service Agreement benefit PSE&G's firm residential and commercial customers. In order to effectuate the Amended PPA and to allow Eagle Point to move into a merchant mode of electric generation, Eagle Point and PSE&G have negotiated a new natural gas supply arrangement for the Facility, with the Existing Gas Service Agreement being replaced by the Amended Gas Service Agreement and the Gas Call Agreement. Co-Petitioners assert that the Board's approval of the Amended Gas Service Agreement and the Gas Call Agreement is a necessary condition precedent to the effectiveness of the Amended PPA.

Co-Petitioners assert that there are two primary benefits to gas customers associated with the Existing Gas Service Agreement. First, Eagle Point provides an ongoing contribution towards PSE&G's fixed gas costs. Second, a provision of the Existing Gas Service Agreement allows PSE&G to interrupt deliveries to the Facility when temperatures are forecasted to be 22 degrees Fahrenheit or less, which effectively provides a very economical peaking service for PSE&G's firm gas customers.

PSE&G asserts that it was not willing to enter into the Amended PPA unless the Existing Gas Service Agreement could be restructured in a way that would leave gas customers at least as well off as they are under the existing agreement. PSE&G and Seller assert that the Amended Gas Service Agreement satisfies this requirement by requiring Eagle Point to make PSE&G whole for all fixed costs that would have otherwise been paid under the Existing Gas Service Agreement. In addition, the Gas Call Agreement provides a call option to PSE&G that effectively preserves the interruption benefits of the Existing Gas Service Agreement for PSE&G's firm customers.

Co-Petitioners assert that, by entering into the Amended Gas Service Agreement and the Gas Call Agreement, PSE&G's gas customers are in a better position than they would have been under the current gas service arrangements. The Amended Gas Service Agreement extends the term for five additional years through March 31, 2016 and eliminates the alternate fuel reimbursement[6] provision in the Existing Gas Service Agreement, ultimately reducing the price of natural gas supplies to PSE&G's gas customers during peak demand periods. Further, the margin charged to Eagle Point under the Amended Gas Service Agreement will be collected on a demand, rather than a volumetric, basis based on historical usage, thus protecting PSE&G's

[6] In approving the Existing Gas Service Agreement, the Board allowed PSE&G to recover, through its levelized gas adjustment clause, all costs associated with the reimbursement of alternate fuel costs to Eagle Point when long term firm transportation service to the Facility is interrupted.

gas customers from a potentially lower capacity factor of the Facility. In addition, the Gas Call Agreement addresses certain operational issues inherent in the existing arrangement regarding the receipt of peak day volumes into PSE&G's system when the Facility is interrupted. Co-Petitioners assert that this operational change ensures that PSE&G will receive its maximum entitlement of peak day supplies under the terms of the Amended Gas Service Agreement.

Recovery of Restructuring-Related Costs

Co-Petitioners assert that the Amended PPA will result in a $100 million up-front reduction in PSE&G's stranded costs, which reduction will be reflected fully upon its receipt through the application of the Restructuring Credit to the NTC deferred balance authorized by the Board in the PSE&G Final Order. Co-Petitioners seek a determination that the Amended PPA will result in a substantial reduction in the total stranded costs of the Company, which resulting savings will be passed through to electric customers on a full and timely basis, pursuant to N.J.S.A. 48:3-61(l)(1). Co-Petitioners further seek a finding by the Board that, pursuant to N.J.S.A. 48:3-61(l)(3)(a), all costs and charges to be paid by PSE&G for capacity and energy, pursuant to the Amended PPA, will qualify for full and timely recovery by PSE&G, and that any such costs which are above market would be recovered through the NTC in PSE&G's tariff as "stranded costs" under the Electric Discount and Energy Competition Act ("EDECA"), N.J.S.A. 48:3-49 et seq. In addition, Co-Petitioners seek a finding that the Board's approval of the Amended PPA would not be subject to further Board modification except as jointly requested by Co-Petitioners, pursuant to N.J.S.A. 48:3-61(l)(4).

Rate Treatment of Electric Revenues

PSE&G asserts that it has actively sought to mitigate its stranded costs associated with non-utility generation ("NUG") contracts through direct negotiations with NUG owners. The Company asserts that, including the Eagle Point Amended PPA, it will have completed eight NUG restructurings over the last three years, including its four largest NUG power purchase agreements, with a total estimated benefit to electric customers of $264 million on a net present value basis. PSE&G asserts that, in prior petitions, the Company has not requested the Board to allow the Company's shareholders to share in the benefits. However, the Company asserts that, in the instant proceeding, a sharing mechanism is appropriate.

PSE&G is requesting that the Board approve a credit from the NTC to electric revenues of $10 million, representing 10% of the Restructuring Credit resulting from the Eagle Point Amended PPA, thereby providing an incentive for the Company to continue with future NUG restructuring efforts that are likely to be more difficult and costly. The Company asserts that such an incentive is consistent with the Board's prior determination in its Final Order, dated March 30, 2001, In the Matter of Atlantic City Electric Company – Rate Unbundling, Stranded Cost and Restructuring Filings, Docket Nos. EO97070455, EO97070456 and EO97070457, wherein the Board allowed an incentive of 10% of the savings of NUG buyouts, buydowns or restructurings to the extent that the 10% aggregate rate reduction required by EDECA relative to April 30, 1997 rates is achieved without the use of cost deferrals.

Rate Treatment of Gas Revenues

PSE&G asserts that it has restructured the gas supply arrangement for the Facility to benefit gas customers by preserving and/or enhancing the primary benefits to gas customers of the existing gas supply arrangements as described above. Accordingly, PSE&G requests that the Board approve the proposed Gas Agreements and authorize the Company to retain the revenues equivalent to 15% of the annual margin recovered from Eagle Point under the Amended Gas Service Agreement.[7]

Request for Confidential Treatment

Co-Petitioners assert that Exhibits E and F attached to the petition, Articles IV and V and Exhibits 1, 2 and 3 of the Amended PPA, Sections 3.3, 4.1, 5.3, 5.4 and 13.1 of the Amended Gas Service Agreement are confidential in nature, inasmuch as they contain pricing and other delivery and cost information that is proprietary to El Paso and PSE&G. Accordingly, Co-Petitioners request that the aforementioned Exhibits, Articles and Sections be kept confidential and not be disclosed to anyone other than the Board, Board Staff, and the Advocate, for a period of not fewer than two (2) years from August 14, 2001, the filing date of the petition.

By letter dated August 27, 2001, Co-Petitioners submitted affidavits in support of their request for confidential treatment, and to request that their original request be supplemented to include Sections 1.18 and 4.1 of the Gas Call Agreement. PSE&G asserts that the Amended Gas Service Agreement and the Gas Call Agreement contain information that, if disclosed to the Company's competitors, other customers, potential suppliers or the public in general, would provide a significant and unfair competitive advantage to those parties to the detriment of PSE&G and its customers. Eagle Point asserts that the Amended PPA, the Amended Gas Service Agreement and the Gas Call Agreement contain information that, if disclosed to El Paso's competitors, other customers, potential suppliers or the public in general, would provide a significant and unfair competitive advantage to those parties to the detriment of El Paso.

Request for Expedited Treatment

Co-Petitioners are requesting the Board's expeditious review of the petition. Co-Petitioners assert that the Amended PPA is an integral part of PSE&G's efforts to reduce stranded costs and rates, as required by N.J.S.A. 48:3-49 et seq. Co-Petitioners further assert that Seller's willingness to agree to the terms of the Amended PPA is predicated on Seller's ability to secure financing for the restructured agreement at favorable interest rates. In addition, the Amended PPA provides for a reduction in the $100 million Restructuring Credit for each day of delay, in the amount of $29,411 per day after December 31, 2001, the proposed effective date of the Amended PPA.

Advocate Comments

By letter dated October 5, 2001, the Advocate submitted its comments in this matter. The Advocate asserts that, while it is generally supportive of restructuring uneconomic NUG contracts to lower costs to customers, it has several concerns about the Co-Petitioners' proposal.

The Advocate argues that the up-front $100 million Restructuring Credit has insufficient justification and that the indicated 7.6% reduction in electric pricing is not adequately captured in the payment by Seller to PSE&G. The Advocate asserts that the fixed electric prices in the Amended PPA have not been set equal to current and estimated future rates in the existing PPA as asserted in the petition, and that the proposed fixed electric prices are actually above the current estimates of future prices in the existing PPA. The Advocate asserts that, based on analysis of recent declines in forecasted natural gas costs, the Amended PPA actually

[7] In response to Discovery Request EP-RAR-87, PSE&G estimated revenues equivalent to 15% of the margin recovered under the Amended Gas Service Agreement as being approximately $4.7 million (37,000 Dektherms/day X 365 days/year X $0.16464/dekatherm X 14 years X 15% = $4.7 million). The equivalent 100% of the margin would be approximately $31.1 million, or approximately $2.2 million/year.

increases future electric purchased power prices by about $113 million compared to the Existing PPA.[8]

The Advocate also asserts that, contrary to the Company's proposal that the Restructuring Credit be used to offset the Company's deferred balances, the payment will only serve to increase the NTC surplus. While the Advocate acknowledges that the surplus could be used to offset the underrecovery balance in the Company's Societal Benefits Charge ("SBC"), the Advocate argues that it would be inequitable to offset SBC costs, most of which are for past undercollections of conservation measures, by benefits related to prospective decreases in electric costs. The Advocate recommends that, if the Amended PPA is approved, that the fixed electric prices contained therein be updated to reflect a $113 million decrease and passed through to customers over the life of the Amended PPA. Alternatively, the Advocate recommends that any up-front payment be increased to $150 million to reflect the additional reduction in natural gas prices since the Amended PPA was negotiated.

The Advocate opposes any incentive to PSE&G for its restructuring efforts associated with the Amended PPA, arguing that incentives should only be provided for clear, quantifiable and significant customer savings which, the Advocate asserts, are not evident in this instance. As discussed above, the Advocate argues that the Amended PPA does not provide any obvious net financial advantages to customers but, rather, has the potential of harming customers over the remaining 15 years of the agreement. The Advocate posits that the Company's affiliate that previously had an ownership interest in the Facility has benefited both from its ownership interest and in the sale of that interest. The Advocate further posits that PSE&G had an economic incentive to mitigate the Existing PPA while its affiliate had an ownership interest in the Facility, but commenced renegotiation of the agreement only when that ownership interest ceased. The Advocate argues that customers should not have to contribute any more money to the Company's shareholders relating to the operation of the Facility.

The Advocate also opposes any retention of revenues relating to the Amended Gas Service Agreement. The Advocate argues that the Company was allowed to retain $5.5 million of revenues when it negotiated the Existing Gas Service Agreement, with all margins thereafter o be credited 100% to customers. The Advocate asserts that the claimed gas customer benefits under the Amended Gas Service Agreement are illusory, in that if PSE&G is allowed to retain 15% of the associated gas margins, current customer credits of 100% of such margins under the Existing Gas Service Agreement will be reduced, thereby harming customers. The Advocate notes that the Existing Gas Service Agreement terminates in 2011 while the Amended Gas Service Agreement will be extended to 2016. The Advocate argues that the five-year extension will be dependent upon whether the Company and Eagle Point are able to reach agreement on the level of the third party service charge to be effective from 2011 through 2016. Therefore, the Advocate argues that the Company's request to retain a portion of the margin revenues should be denied or, alternatively, deferred until such time as PSE&G can demonstrate that the five-year extension has occurred and that it has quantifiable benefits for ratepayers.

The Advocate does acknowledge a small enhancement for customers under the Gas Call Agreement whereby PSE&G has increased access to the Facility's gas supply under certain conditions during the winter months. The Advocate also acknowledges that the elimination of the alternate fuel reimbursement provision in the Gas Call Agreement indicates, based on historical data, that there may be some benefit to the revised pricing of the fuel reimbursement rate, although the Advocate posits that, based on current oil vs. natural gas price trends, a case could be made

[8] The Advocate relies upon a natural gas forecast dated September 20, 2001 for its analysis.

that the existing alternate fuel rate may be less than future natural gas pricing. The Advocate concludes that these two changes constitute the principal amendments to the Existing Gas Service Agreement and that, while there may be minor benefits associated with these changes, there also exists the possibility that customers could be harmed under equally possible conditions.

PSE&G Comments

By letter dated October 10, 2001, PSE&G submitted its comments in response to the comments submitted by the Advocate. The Company notes that this matter represents the third PPA restructuring between PSE&G and El Paso that has been brought before the Board since April 2000. The Company argues that the previous two contract restructurings were approved by the Board,[9] and asserts that this third such transaction was intentionally modeled after the previously approved restructured PPAs.

PSE&G argues that the Amended PPA provides for known, fixed prices based, in part, on projected natural gas prices rather than a component that floats monthly based on a short-term natural gas market price index. The Company asserts that the prices in the Amended PPA are therefore fixed for the remaining fifteen-year term of the agreement and will no longer be indexed. The Company asserts that, in order to fix the electric prices in the Amended PPA, a long-term gas forecast was utilized. The Company asserts that, since the agreement was finalized in June 2001, PSE&G and Eagle Point used gas prices as they were traded during June 2001 as the basis of the forecast. The Company further asserts that these prices are significantly lower than the prices utilized in the most recent amended PPA approved by the Board in July 2001. The Company argues that the fixed price in the Amended PPA therefore offers a hedge against gas prices that offers a long-term benefit.

PSE&G asserts that, contrary to the Advocate's arguments, there is no validity in trying to analyze a fifteen-year PPA based on daily and seasonal price variations in the wholesale natural gas market. The Company argues that, during 2000, prices ranged from about $2.00 per dekatherm to above $10.00 per dekatherm. The Company further argues that the current wholesale market is similar to the wholesale market that existed in late 1999 and that natural gas prices are cyclical and, therefore, remain volatile. PSE&G asserts that the Company and Eagle Point negotiated the Amended PPA based on the best information available at the time of negotiation, and that the June 2001 gas forecast is reasonable. The Company asserts that the $100 million up-front Restructuring Credit provides an immediate benefit to customers, while the fixed electric prices provide a long-term benefit to customers.

PSE&G argues that its requested incentive payment of $10 million is reasonable in light of the benefits that will be received by customers. The Company also argues that the incentive payment will provide financial motivation to pursue future PPA restructurings that are likely to require the Company to assume greater financial risks. The Company disputes the Advocate's argument that customer savings have not been demonstrated to be clear, quantifiable and significant. The Company asserts that the Advocate's primary claim against the alleged lack of benefits is based on a disagreement over the natural gas price forecast used in negotiating the Amended PPA.

[9] A restructured PPA with Newark Bay Cogeneration Partnership ("Newark Bay") was approved by the Board by Order dated July 7, 2000. A restructured PPA with Camden Cogen, L.P. ("Camden") and Cogen Technologies NJ Venture ("Bayonne") was approved by the Board by Order dated July 24, 2001.

PSE&G also asserts that the Advocate's arguments regarding the prior ownership of Eagle Point by the Company's unregulated affiliate are without merit. The Company asserts that the pricing structure under the Existing PPA resulted in lower prices than prices being paid by other New Jersey utilities for NUG contracts. The Company further asserts that there is no evidence that the Company's affiliate received any more than market value when it sold its interest in the Facility. PSE&G also disputes the Advocate's argument that the Company waited until after its affiliate sold its interest to restructure the Existing PPA, asserting that the Company began restructuring discussions with the non-affiliate operator of the Facility before the sale occurred.

PSE&G notes that the Advocate is not opposing the Amended Gas Service Agreement, but only objects to the incentive requested by the Company relating to the agreement. The Company asserts that the term extension of the Amended Gas Service Agreement can only benefit customers, proving a minimum of $11 million in additional margin payments under certain conditions. The Company also asserts that, contrary to the Advocate's argument that the annual gas margin is now capped at $2.2 million, the Amended Gas Service Agreement now guarantees a minimum margin of $2.2 million, with the possibility of additional margins accruing to customers. Lastly, PSE&G asserts that the Company and the Advocate agreed to a gas margin incentive to the Company in the last two NUG restructurings, each of which included amended gas agreements, and that the Company's request in this matter, relative to the Amended as Service Agreement, is no different from those previous NUG restructurings.

<u>Advocate Reply Comments</u>

By letter dated October 17, 2001, the Advocate responded to the Company's comments.

The Advocate acknowledges that a hedge position, such as is asserted by the Company to be the case with the fixed electric price provision in the Amended PPA, does reduce exposure to price volatility. However, the Advocate argues that the value or benefit of a hedge position is ultimately determined by the price which is established, which the Advocate asserts to be unreasonable in this case. For this reason, the Advocate opposes the Amended PPA pricing. The Advocate reiterates its previous argument regarding natural gas forecasts, asserting that prices during the 2000-2001 period were not representative of typical seasonal movements in prices and, therefore, not reflective of the long-term trend in natural gas prices. The Advocate asserts that the Company's June 2001 forecast uses an average forecast price that is well above the long-term wholesale gas level, thereby requiring customers to pay an unjustifiable premium under the Amended PPA, even with the up-front $100 million Restructuring Credit. The Advocate argues that customers would receive a greater benefit by continuing the indexed monthly pricing in the Existing PPA.

The Advocate maintains that there is no real economic benefit derived from the Amended PPA and, therefore, no incentive is warranted. The Advocate refutes the Company's argument that an incentive is warranted, arguing that the Company has an obligation to obtain the lowest reasonable costs for its customers without any financial rewards above the Company's allowed rate of return. The Advocate also asserts that the Company's shareholders have not borne any risks associated with NUG contracts or their renegotiation and are not entitled to any rewards or incentives. The Advocate rejects PSE&G's argument that the Company should receive incentives in this instance because the Advocate agreed to incentives in two prior restructurings. The Advocate asserts that those prior restructurings provided additional benefits to customers beyond the benefits included in the original agreements. The Advocate asserts that customers will not receive any quantifiable additional benefits under the Amended PPA and that they could possibly lose money under the proposed amendments.

Discussion and Findings

The Board has reviewed this matter, including the comments submitted by the Advocate and the Company. As a preliminary matter, the Board rejects the Advocate's arguments that Co-Petitioners' negotiation of the Amended PPA inappropriately relies upon a June 2001 natural gas forecast instead of a later forecast that yields a lower price. While it is desirable to attempt to obtain the most favorable price forecast in negotiating a restructured agreement based upon fluctuating natural gas prices, there can be no up-front certainty that any particular long-term forecast made at a given point in time will, in fact, be at or near the optimum level over the life of the forecast. There can also be no up-front certainty that any long-term price projection (e.g., fifteen years) will or will not yield a particular level of benefits for customers during the term of the Amended PPA. What is certain, however, is that there are quantifiable benefits identified at this time that will accrue to customers upon the execution of the Amended PPA, such as the $100 million Restructuring Credit, which will serve to offset distribution costs to customers. Reliance on June 2001 data does not appear to be unreasonable which, as asserted by the Company, yields lower prices than the successfully restructured PPA among PSE&G, Camden and Bayonne approved by Board Order dated July 24, 2001.

Based on the foregoing, the Board HEREBY FINDS that the negotiation and execution of the Amended PPA and the related Interconnection Agreement appear to comply with the directives and conditions set forth in the PSE&G Final Order, which require PSE&G to take steps to mitigate NUG-related stranded costs and to make reasonable efforts to renegotiate its above-market NUG contracts. While the instant agreements will not eliminate above-market NUG costs associated with the Existing PPA, based upon current market price projections, it appears that the rates, terms and conditions of the Amended PPA and Interconnection Agreement will provide immediate and substantial benefits to customers relative to the existing agreements, although the Board notes that the Company is assuming some additional risks by agreeing to provide Seller with flexibility in fulfilling its delivery obligations. However, the Amended PPA should also provide greater reliability in the delivery of energy to PSE&G as a result of Seller's obligation to provide energy from its portfolio of generation resources rather than from specific facilities.

As noted above, an immediate and noteworthy benefit of the instant transaction will be the receipt by PSE&G of the up-front Restructuring Credit payment in the amount of $100 million, which within two days of the effective date of the Amended PPA, will be credited by PSE&G to the NTC deferred balance. The Restructuring Credit is projected increase the deferred balance surplus of $5 million as of January 1, 2002 and leave the NTC account with a positive balance of approximately $105 million as of that date. The positive balance shall also accrue interest to the benefit of customers. All other things being equal, the Restructuring Credit of $100 million is equivalent, in net present value terms, to the achievement of an approximate 7.6% reduction of the future PPA prices without the need for any up-front, lump sum payment on the part of PSE&G. Consistent with its previous NUG restructuring decisions with respect to PSE&G, the Board continues to believe that the front-end loading of these savings through the Restructuring Credit will help to mitigate the potential impacts on customers of deferred balances after the expiration of the EDECA-mandated four-year transition period on August 1, 2003. However, as noted above, during the term of the Amended PPA, actual natural gas prices may vary either above or below the projections used to establish the fixed rates. Thus, the actual savings associated with the Amended PPA over the term of the agreement cannot be quantified at this time. Overall, the long-term forecast of natural gas prices used by Co-Petitioners in establishing the fixed energy prices in the Amended PPA is lower than the forecast used most recently involving a restructured PPA among PSE&G, Camden and Bayonne and appears to provide an acceptable level of benefits to customers relative to the potential risks associated with such projections.

An additional benefit associated with the Amended PPA is the return of the Coastal refinery as a distribution customer of PSE&G. The estimated additional contribution to the Company's wires charge accounts of approximately $2.3 million annually will provide a benefit to customers in addition to the Restructuring Credit.

The Board further FINDS that, while providing a limited degree of delivery flexibility to Seller, the Amended PPA contains provisions ensuring that PSE&G will receive guaranteed amounts of energy during on-peak periods, when the energy has the most value. Furthermore, the Amended PPA requires Seller to make PSE&G whole for any failure to meet these requirements. Moreover, in the event that Seller engages in any energy sales that constitute on-site generation, as defined in N.J.S.A. 48:3-77, Seller has agreed to reimburse PSE&G for any societal benefits charges, market transition charges, or transition bond charges that PSE&G would have otherwise collected in connection with such sales. Accordingly, PSE&G and its customers should be adequately protected against any potential revenue loss and rate impact that might otherwise occur as a result of the Facility operating in a merchant mode and subsequently being able to sell power directly to on-site customers.

Co-Petitioners have requested that the Board permit all amounts paid by PSE&G under the Amended PPA to be recovered on a full and timely basis, and that any above-market costs be recovered through the NTC. The Board HEREBY FINDS that PSE&G shall be able to fully and timely recover from its electric customers all incurred costs and charges associated with the Amended PPA through the established rate recovery mechanisms, including recovery of above-market payments through the NTC. The Board further DIRECTS that all savings resulting from the Amended PPA shall be passed through to the Company's electric customers on a full and timely basis, again through the established mechanisms, in particular through the application of the $100 million Restructuring Credit to reduce the NTC deferred balance. Interest shall be added to any deferred balance surplus, further benefiting customers. The immediate effect will be the conversion of a projected $5 million NTC deferred balance surplus as of January 1, 2002 to a projected $105 million NTC deferred balance surplus as of January 1, 2002, and an estimated reduction of PSE&G's overall level of the deferred balance at the end of the transition period by approximately $111 million (including estimated accrued interest savings on the resultant lower deferred balance from January 2002 through July 2003). As noted above, the actual savings associated with the Amended PPA relative to the Existing PPA may be higher or lower, depending on whether the natural gas price projections used to establish the fixed rates in the Amended PPA are higher or lower than actual natural gas prices over the term of the agreement. Based upon the foregoing, the Board HEREBY APPROVES the Amended PPA consistent with, and pursuant to, the provisions of N.J.S.A. 48:3-61(l). The Board also HEREBY APPROVES the related Interconnection Agreement.

The Board further FINDS that the Gas Agreements maintain the primary benefits of the existing gas supply arrangements, whereby PSE&G and its natural gas customers have no responsibility for payments associated with the interstate pipeline contracts entered into and maintained to serve the Facility, and whereby an economical peaking service is maintained for PSE&G firm gas customers, as more fully described above. Indeed, the Amended Gas Service Agreement enhances customer benefits by converting all fixed cost recovery from a volumetric basis to a demand basis, thereby enhancing the assurance of fixed cost recovery. The new Gas Call Agreement preserves the interruption benefits for PSE&G firm customers, providing PSE&G exclusive and unlimited access to the firm capacity of the Facility. The Board HEREBY

APPROVES the Gas Agreements, consisting of the Amended Gas Service Agreement and the Gas Call Agreement.

PSE&G is requesting that the Board approve a sharing mechanism in this matter whereby the Company would credit $10 million, or 10% of the Restructuring Credit arising from this transaction, from the NTC to electric revenues to be paid upon closing of the Amended PPA. With respect to PSE&G's request, it should be noted that N.J.S.A. 48:3-61(l)(1) requires that all resultant savings from the renegotiation of a power purchase agreement be passed through to customers on a full and timely basis. Notwithstanding the above, the Company is relying, in part, on the ACE Final Order, wherein ACE was provided a qualified incentive to restructure NUG contracts. ACE's cost deferrals consist of a market transition charge, NUG restructuring costs and SBC costs. To the extent that any such cost deferrals exist during the time when the 10% minimum statutory rate reduction is being implemented, ACE will be unable to benefit from an incentive mechanism. PSE&G is seeking to receive the incentive payment upon closing of the Eagle Point transaction, regardless of whether cost deferrals exist. While the NTC will have a positive balance upon closing of the Amended PPA, there will be other cost deferrals associated with the Company's SBC, basic generation service and other restructuring-related costs, and thus, such an incentive payment is not appropriate, even applying the standards used in the ACE Final Order.

The Board agrees with the Advocate that PSE&G's request to retain $10 million of the $100 million Restructuring Credit as an incentive for restructuring the Existing PPA is not appropriate. While the Company argues that such an incentive is appropriate in this instance and will provide financial motivation to pursue future PPA restructurings that are likely to require the Company to assume greater financial risks, the Board is not persuaded by this argument. PSE&G is under an affirmative legal duty to mitigate its NUG stranded costs, without retaining any additional incentives. N.J.S.A. 48:3-61(f) and N.J.S.A. 48:3-61(l). Therefore, the Board FINDS that it would not be appropriate to deprive electric customers of full and timely savings resulting from this, or any other, NUG contract restructuring. Based on the foregoing, the Board DENIES the Company's request to retain any incentive relating to the Amended PPA.

PSE&G is also requesting an incentive relating to the Amended Gas Service Agreement. While the Company argues that the Advocate agreed to similar incentives in two prior NUG restructurings, the Board recognizes that those agreements were the result of negotiations between the Company and the Advocate, which is not the case here. In considering the arguments of both the Company and the Advocate with regard to a margin sharing mechanism related to the Amended Gas Service Agreement, the Board believes that it is appropriate to allow PSE&G to retain 10% of the annual revenues, or approximately $220,000 per year over the remaining term of the Amended Gas Service Agreement. However, the Board shares the Advocate's concern that there is an uncertainty as to whether the Amended Gas Service Agreement will be extended an additional five years from its expiration in 2011 to 2016. Since those additional five years provide the quantifiable benefits to customers resulting from the Amended Gas Service Agreement, the Board FINDS that any sharing of revenues between the Company and its customers in this instance shall be conditioned upon the Company successfully negotiating the extension of the Amended Gas Service Agreement through 2016, thereby preserving the existing benefits to customers. Therefore, the Board APPROVES a sharing formula wherein the Company shall retain 10% of all gas revenues associated with the Facility, and the remaining 90% of revenues shall continue to flow to customers, provided that the Company is able to successfully negotiate an extension of the Amended Gas Service Agreement from 2011 to 2016. Such a sharing shall be interim and subject to refund in the event that the Amended Gas Service

Agreement is not extended pursuant to the provisions contained therein. PSE&G shall make a future filing with the Board when the status of the extension is known.

With regard to Co-Petitioners' request for confidential treatment of certain information contained in the petition and related Agreements as described above, and the supplemental request contained in Co-Petitioners' letter dated August 27, 2001, the Board HEREBY FINDS this limited request to be reasonable and appropriate at this time, based upon the representations that the petition and related Agreements contain information that is proprietary to PSE&G and El Paso, and that disclosure thereof may provide a significant and unfair competitive advantage to other parties identified in Co-Petitioners' affidavits seeking confidential treatment. Therefore, the Board HEREBY APPROVES the request for confidential treatment of the requested information for a period of two (2) years from the filing date of the petition until August 14, 2003.

The Board HEREBY DIRECTS Co-Petitioners to submit fully executed copies of the signature pages to the Interconnection Agreement and the Amended Gas Service Agreement, and evidence of the application of the Restructuring Credit to the NTC deferred balance, within ten (10) days of execution of those agreements.

DATED: November 8, 2001

BOARD OF PUBLIC UTILITIES
BY:

(SIGNED)

CONNIE O. HUGHES
PRESIDENT

(SIGNED)

FREDERICK F. BUTLER
COMMISSIONER

(SIGNED)

CAROL J. MURPHY
COMMISSIONER

ATTEST: (SIGNED)

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